

*Retiring South Carolina's Public Workforce  
For Life*



# Comprehensive Annual Financial Report

**For the Fiscal Year Ended June 30, 2007**  
Pension Trust Funds of the State of South Carolina

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**South Carolina Retirement Systems**  
*A Division of the South Carolina State Budget and Control Board*

# **Comprehensive Annual Financial Report**

**Fiscal Year Ended June 30, 2007**

**Pension Trust Funds of the State of South Carolina**

**Fontaine Business Center  
202 Arbor Lake Drive  
Columbia, South Carolina 29223**

**Peggy G. Boykin, CPA  
Director**

**Prepared through the joint efforts of the Retirement Systems' staff.**

This report was printed in-house.

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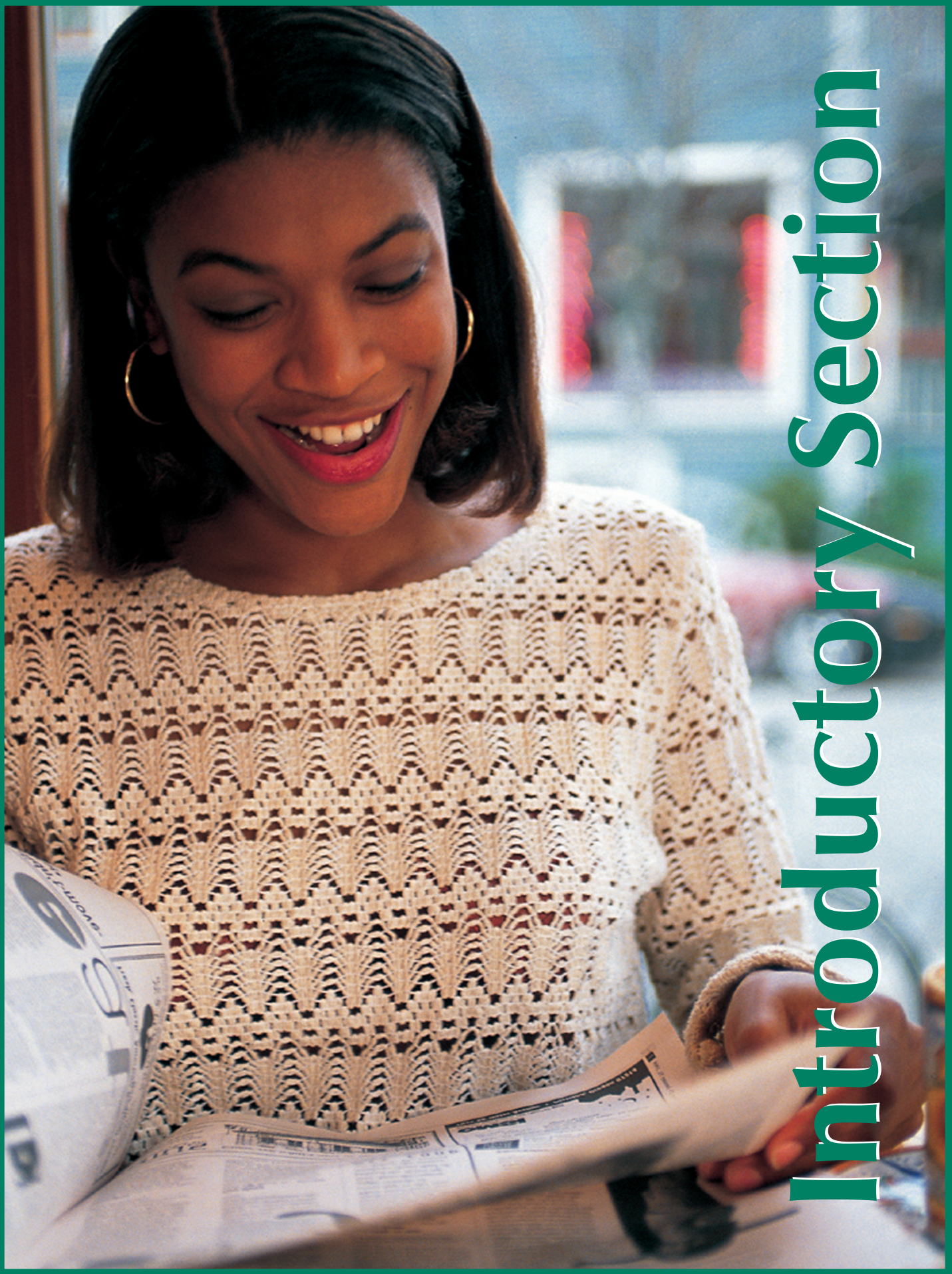
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# Introductory Section

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# Introductory Section

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Mark Sanford, Chairman  
Governor  
Converse A. Chellis, III, CPA  
State Treasurer  
Richard Eckstrom  
Comptroller General

## State Budget and Control Board South Carolina Retirement Systems



Peggy G. Boykin, CPA  
Director

1-803-737-6800

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Hugh K. Leatherman, Sr.  
Chairman,  
Senate Finance Committee  
Daniel T. Cooper  
Chairman,  
Ways and Means Committee  
Frank W. Fusco  
Executive Director

### LETTER OF TRANSMITTAL

November 27, 2007

The Honorable Mark Sanford, Governor  
and  
State Budget and Control Board  
State of South Carolina

Gentlemen:

We are pleased to present the *Comprehensive Annual Financial Report* (CAFR) of the South Carolina Retirement Systems for the fiscal year ended June 30, 2007. The South Carolina Retirement Systems is required by Section 9-1-300 of the South Carolina Code of Laws to publish annually a report of the fiscal transactions of the system and this CAFR fulfills that statutory requirement. Since the Retirement Systems is a part of the primary government of the state of South Carolina, the Systems' financial information is also included in the comprehensive annual financial report of the state. Responsibility for both the accuracy of the data, and the completeness and reliability of the presentation, including all disclosures, rests with the management of the Systems. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of the Systems.

The CAFR was prepared to conform to the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board (GASB). Transactions of the Systems are reported on the accrual basis of accounting. Sufficient internal accounting controls exist to provide reasonable assurance regarding the safekeeping of assets and fair presentation of the financial statements and supporting schedules. The financial statements presented in this CAFR have been independently audited by Rogers Laban, PA, Certified Public Accountants, under the direction of the State Auditor's Office. Rogers Laban issued an unqualified opinion, which means that based upon the audit, they concluded that the financial statements were fairly presented in all material aspects and free from material misstatement. In accordance with *Governmental Auditing Standards*, as part of obtaining reasonable assurance about whether the Systems' financial statements are free of material misstatement, Rogers Laban also considered internal controls over financial reporting and compliance with certain provision of laws, regulations, contracts, and other matters. Although independent auditors cannot guarantee the accuracy of the statements, they do have a reasonable basis for the opinion they render. The independent auditor's report is presented as the first component of the financial section of this report.

### Profile of the Systems

The South Carolina Retirement Systems administers five defined benefit pension plans that provide lifetime retirement annuities, disability benefits and death benefits to eligible members. The plans' terms specify the amount of pension benefits to be provided at a future date or after a certain period of time. The amount specified is a function of a formula based on years of service, compensation, and age. Our administrative and reporting structure is outlined in the introductory section of this report.

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## Introductory Section

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This report contains information on the following defined benefit pension trust funds:

- The South Carolina Retirement System (**SCRS**) was established July 1, 1945, to provide retirement and other benefits for teachers and employees of the state and its political subdivisions.
- The Police Officers Retirement System (**PORS**) was established July 1, 1962, to provide retirement and other benefits to police officers and firefighters.
- The Retirement System for Members of the General Assembly of the State of South Carolina (**GARS**) was established January 1, 1966, to provide retirement and other benefits to members of the General Assembly.
- The Retirement System for Judges and Solicitors of the State of South Carolina (**JSRS**) was established July 1, 1979, to provide retirement and other benefits to state Judges and Solicitors.
- The National Guard Retirement System (**NGRS**) was established July 1, 1975, to provide supplemental retirement benefits to members who served in the South Carolina National Guard. Legislation transferred administrative responsibility of the plan from the Adjutant General's Office to the South Carolina Retirement Systems effective January 1, 2006.

### Fiscal Year 2007 Highlights

During Fiscal Year 2007, the South Carolina Retirement Systems continued to maintain high stakeholder satisfaction amid a pressing workload, which included the development and/or the implementation of multiple member-centric projects. The Systems made major procedural and information systems modifications to accommodate provisions of the Pension Protection Act of 2006.

In November 2006, South Carolina voters passed a referendum to amend the state constitution to allow full diversification of the South Carolina Retirement Systems' investment portfolio. The amendment was ratified by the South Carolina General Assembly in February 2007, permitting the South Carolina Retirement System Investment Commission (RSIC) to invest the trust funds in a more diverse group of investments and among more asset classes, which will allow the Retirement Systems' trust funds to be on a level playing field with other public retirement funds across the nation and provide opportunities for strengthening the long-term health of the Systems.

### South Carolina Retirement System Investment Commission

The South Carolina Retirement System Investment Commission (RSIC) was established effective October 1, 2005. In November 2006, Amendment 3a, a referendum to allow full diversification of the South Carolina Retirement Systems' portfolio, was on the statewide ballot. South Carolina voters approved the referendum at the polls last fall and the South Carolina General Assembly ratified the referendum in February 2007. Since its inception, the RSIC has made significant progress in implementing a complete restructuring of the state's investment program for the Retirement Systems' \$28 billion pension trust fund. The RSIC has contracted with New England Pension Consultants (NEPC) for general investment consulting services, and has conducted an asset/liability modeling study through Mercer Investment Consulting, Inc., and a cost benchmarking study by Cost Effectiveness Measurement, Inc. In addition to implementing the transition of the Retirement Systems' fixed income assets from the State Treasurer's Office to the RSIC, the RSIC is restructuring the Retirement Systems' portfolio through the development of private equity, portable alpha, global fixed income, and domestic and international equity portfolios. The asset allocation transition, and in particular the development of private equity, portable alpha, fixed income, and domestic equity portfolios, is an ongoing process. The Commission is an independent agency with additional professional and administrative staff that assists in the monitoring of investment managers and in implementing the Commission's decisions.

### South Carolina Retirement Systems' First-Ever Identity Statement

This year, the South Carolina Retirement Systems introduced its first-ever, fundamental identity statement: "*Retiring South Carolina's Public Workforce For Life*." This simple, single statement relays the significance of a public Retirement Systems' benefit and the important value that the plan provides for its stakeholders. It reflects our commitment to our customers and our organization, and gives us a solid foundation for boundless information and educational programs.

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## Introductory Section

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### ***Retiree Return-to-Work Provisions***

South Carolina's retirees benefit from very lenient and generous return-to-work provisions. This was confirmed by an informal survey of retiree return-to-work provisions on the Web sites for similar public employee pension plans in 11 southern states. The states included in the survey are Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Tennessee, Virginia, and West Virginia. Service retirees of SCRS and PORS are allowed to return to work after having been retired for at least 15 days. During retirement, members continue to receive an annuity benefit and have no limit on the amount of wages they may earn from employment. In contrast, many other public retirement plans across the nation require members to forfeit their right to retirement benefits, limit members' earnings, and/or require members to again become active contributing members when they return to covered employment. In South Carolina, retirees who return to work for a covered employer continue to pay employee contributions, which partially fund guaranteed cost-of-living adjustments (COLAs) under SCRS and also help provide funding for ad hoc COLAs under SCRS and PORS.

### ***Transfer of Administration of the South Carolina National Guard Retirement System***

During the prior fiscal year, the South Carolina Retirement Systems assumed administrative responsibilities for the National Guard Retirement System (NGRS) which is a defined benefit pension plan providing supplemental benefits to National Guard members who served in South Carolina. This plan was previously administered by the Adjutant General's Office. The plan's net assets are valued at \$15.9 million and are now invested in the same manner as the funds of the other four pension trust funds administered by the Retirement Systems. Contributions for the NGRS are provided by annual state appropriations based on the annual required contribution determined annually by the actuary. The legislature has made the commitment to appropriate the required contributions during the fiscal year for which they are due, and over time, this commitment will improve the actuarial soundness of the plan. In addition, the NGRS was previously closed to new entrants since July 1, 1993; however, recent legislation reopened the system effective January 1, 2007, to any new entrants since June 30, 1993.

### ***Rankings Among Peer Pension Plans***

The South Carolina Retirement Systems participates in an annual public pension plan benchmarking analysis conducted by Cost Effectiveness Management, Inc., (CEM). Fifty-six public pension plans participated in the 2006 CEM survey, which marked the sixth year of participation for the Retirement Systems.

Although the Retirement Systems is a customer centric organization, we are also a division of South Carolina state government and as such, must adhere to stringent budgetary guidelines. According to the CEM report, the South Carolina Retirement Systems' total adjusted administrative cost per member was \$46 in comparison to a peer median cost of \$83. Our low administrative cost is achieved through the efficient and proactive deployment of automated systems and appropriately allocated human resources.

To continue to provide best practices service levels to our stakeholders, the Retirement Systems must expend the resources necessary to both maintain our infrastructure and expand our technological and human resources. Our infrastructure has been stagnated by mandatory changes required by legislation and court rulings. We have also utilized our human resources far beyond capacity.

### ***Legislative Changes to Retirement System for Judges and Solicitors (JSRS)***

The General Assembly enacted several changes related to JSRS this fiscal year. Previously only judges and solicitors were covered by the system; however, legislation established a statewide unified indigent defense system which will provide JSRS coverage for circuit public defenders throughout the state. Circuit public defenders will have the same vesting and eligibility requirements as solicitors. As of the end of the 2007 fiscal year, the newly created office had not yet been funded or staffed.

Effective June 27, 2007, state statute was also modified to allow members of JSRS to elect to immediately begin receiving an annuity benefit while continuing employment after reaching maximum retirement eligibility (32 years of service for judge and 31 years of service for solicitor or public defender). Employee and employer contributions must continue to be paid as if the judge, solicitor, or circuit public defender was an active contributing member, but no additional service credit accrues. A retired JSRS member may continue to serve as a judge, solicitor, or public defender until the end of the calendar year in which the member attains the age of 72.

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## Introductory Section

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Normal retirement age for JSRS is defined as age 60. If a JSRS member reaches maximum eligibility (32 years of service for judge and 31 years of service for solicitor or public defender) but is under normal retirement age of 60, an annuity benefit cannot be paid to him while he continues employment due to Internal Revenue Service (IRS) in-service distribution restrictions. However, this bill allows the member to apply for retirement upon reaching maximum eligibility and retirement benefits will begin accruing under a deferred retirement option program until the member reaches age 60. At age 60, the accumulated deferred benefits will be distributed; however, no termination of employment is required for the payout to be made. No interest will be paid on the deferred benefits placed in trust.

### ***Implementation of PPA***

The United States Congress passed the Pension Protection Act of 2006 (PPA), which was signed into law by President George Bush August 17, 2006. Although at the crux of this federal law are provisions that apply to private sector pension plans governed by ERISA, there are a few provisions that affected some members of governmental plans such as those administered by the South Carolina Retirement Systems.

The most significant provision for the Systems provides for the pre-tax treatment of qualified health insurance premiums, defined as premiums for coverage for retired public safety officers, their spouses, and dependents, by an accident or health insurance plan, or qualified long-term care insurance contract.

South Carolina was among the first to implement PPA provisions allowing for the pre-tax distributions of up to \$3,000 from public pension plans for use in purchasing retiree health or long-term care insurance by public safety retirees. The legislation also provides that health and long-term care insurance premiums must be deducted from the distributions of a retiree's annuity by the pension plan and paid directly to the insurance provider in order for the premiums to be excluded from taxable income.

This legislation is a tremendous step forward in ending a long-standing inequity of active employees being allowed to use pre-tax dollars to pay health insurance premiums and health care costs and retirees not being able to do so. The impact of the PPA on South Carolina's economy is expected to be positive. There are currently more than 1,600 participants enrolled in the PPA deduction program administered by the South Carolina Retirement Systems. Based on an average deduction of \$174 per month, it is estimated that these members will benefit from an increase in disposable income of almost \$734,000 per year as a result of the federal and state income tax savings.

### **Summary of Financial Condition**

The funding objective of the pension trust funds is to meet future benefit obligations of retirees and beneficiaries through contributions and investment earnings. Our external consulting actuaries determine the actuarial soundness of the plans based on long term obligations and the sufficiency of current contribution levels to fund the liabilities of each plan over a reasonable time frame. In our most recent valuations dated July 1, 2006, our actuarial consultants concluded that all systems are operating on an actuarially sound basis. All five systems are considered to be adequately funded within the Governmental Accounting Board's standards and the Budget and Control Board's policy that requires actuarial liabilities be funded within 30 years. The funded ratio for SCRS, which represents the largest membership of the five plans, decreased from 71.6 percent to 69.6 percent. Approximately half of the decrease in the funded ratio is due to the 3.5 percent ad hoc COLA that was granted effective July 1, 2006. This ad hoc COLA was granted prior to legislation that guaranteed a pre-funded 1 percent COLA to SCRS retirees beginning July 2007. In addition, investment and non-investment related experience losses contributed to the decline in the funded ratio. As a result of these and other factors, the period for amortizing SCRS' unfunded actuarial accrued liability remained constant at 30 years. The current funded ratios of the five plans range from a low of 28.5 percent for NGRS to a high of 84.7 percent for PORS. More detailed information regarding the financial condition of the pension trust funds can be found in the financial and actuarial sections of this report.

An optimally diversified investment portfolio is designed to generate long-term returns sufficient to ensure that the program is financially sound. While the Systems' past investment performance was limited by our state constitution and state statute, during the fiscal year, the RSIC worked diligently to implement a modern-day asset allocation policy. With the help of the RSIC's investment consultants, NEPC, the RSIC began deploying investments across a progressive asset allocation designed to reduce the amount of risk while aiming to increase overall

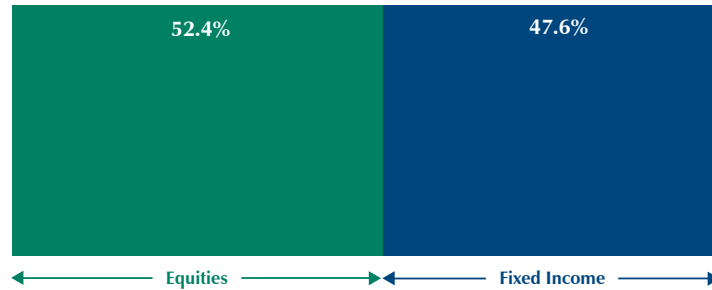
## Introductory Section

returns. In addition to the RSIC's efforts to gain immediate exposure to almost all of the new asset classes, planned strategies that will take several years to implement include more private equity agreements, real estate, and other entrepreneurial opportunities in the hedge fund arena.

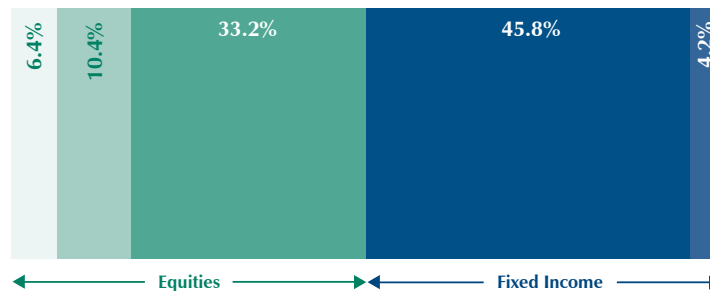
The charts below summarize the Retirement Systems' diversification progress from the prior fiscal year and the long-term target allocation.

### South Carolina Retirement Systems

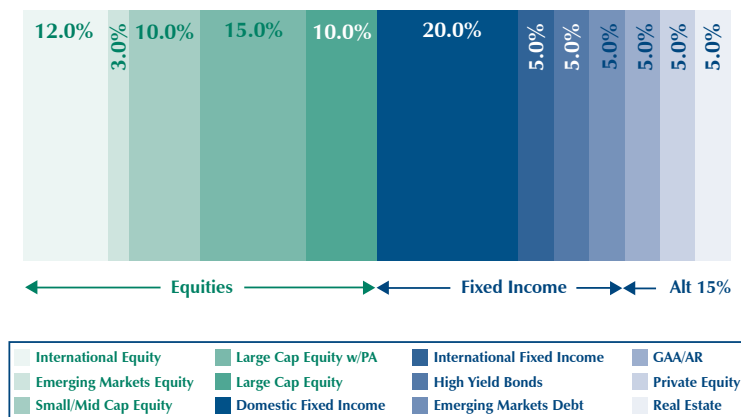
#### Actual Asset Allocation as of June 30, 2006



#### Actual Asset Allocation as of June 30, 2007



#### Target Asset Allocation

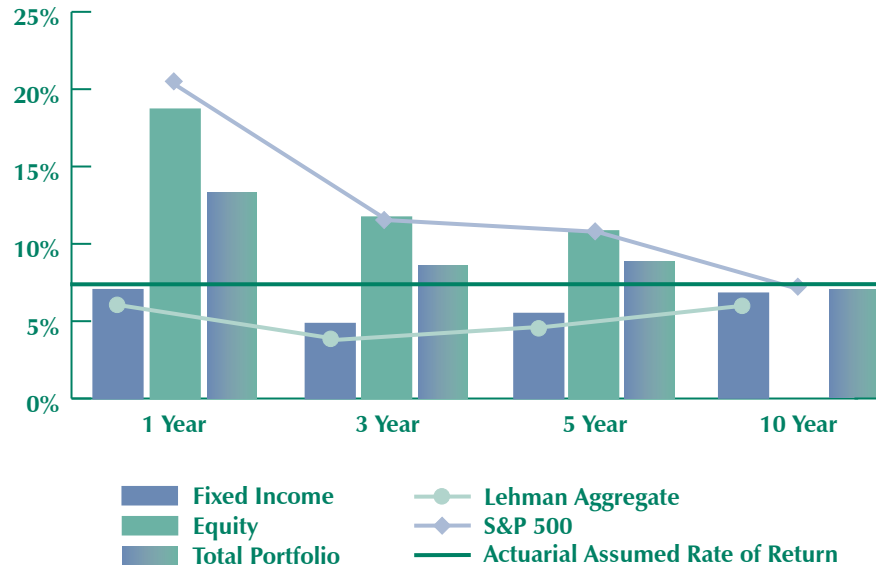




## Introductory Section

For the year ended June 30, 2007, the combined Systems investment portfolio produced a total aggregate investment return of 13.35 percent. Current year performance significantly exceeded our actuarial assumed rate of 7.25 percent; however, the actuarial smoothing methodology offsets any investment gains and shortfalls over a five-year period to mitigate market volatility. The following chart summarizes overall investment performance in comparison to the relevant benchmarks.

**South Carolina Retirement Systems  
Summary of Investment Performance as of June 30, 2007**



Investment performance in comparison to the assumed rate of return is a significant factor in our actuarial valuations. As referred to earlier, our actuarial consultants use an actuarial asset valuation method that recognizes a portion of the difference between the actual market value of assets and the expected actuarial value of assets, based on the assumed investment rate of return of 7.25 percent. This method recognizes 20 percent of the difference between market and expected actuarial value each year and guarantees that any gain or loss is recognized over a five-year period. The actuarial value of assets is limited to a range between 80 percent and 120 percent of market value. This actuarial asset valuation method dampens year-to-year fluctuations, smoothes the effect of volatility in the market and helps provide a consistent estimate of the value of assets. Detailed investment results for fiscal year 2007 can be found within both the financial and investment sections of this report.

It is paramount to note that SCRS is considered actuarially sound. Both annuity benefits and a guaranteed 1 percent COLA under SCRS are sufficiently funded based on current contribution levels; however, any additional ad hoc COLAs beyond the guaranteed 1 percent in SCRS are not pre-funded.

For additional financial information, please refer to management's discussion and analysis, financial statements and schedules included in the financial section of this report.

### Certificate of Achievement

The Government Finance Officers Association (GFOA) of the United States and Canada awarded a Certificate of Achievement for Excellence in Financial Reporting to the South Carolina Retirement Systems for its *Comprehensive Annual Financial Report* (CAFR) for the fiscal year ended June 30, 2006. The Certificate of Achievement is a prestigious national award recognizing excellence in the preparation of state and local government financial reports.

## Introductory Section

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In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report, the contents of which meet or exceed program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid only for a period of one year. The Systems has received a Certificate of Achievement for each of the last 20 consecutive years (fiscal years ended 1987-2006). We believe this 21st issue of our annual report continues to conform to the Certificate of Achievement Program requirements, and we are submitting it to the GFOA for consideration again this year.

### Public Pension Standards Award

The South Carolina Retirement Systems also received the Public Pension Coordinating Council's Public Pension Standards 2007 Award. This is the fourth consecutive year during which the Retirement Systems applied for and received the Council's award in recognition of meeting professional plan design and administration standards. The Public Pension Coordinating Council is a confederation of the National Association of State Retirement Administrators, the National Conference on Public Employee Retirement Systems, and the National Council on Teacher Retirement.

### Acknowledgments

The compilation of this report reflects the combined efforts of the staff of the South Carolina Retirement Systems functioning under your leadership. The report is intended to provide comprehensive and reliable information about the Systems, to demonstrate compliance with legal provisions, and to allow for the evaluation of responsible stewardship of the funds of the Systems.

We express our gratitude to the members of the Board, the staff, the consultants, and the many people who have worked so diligently to assure the continued successful operation of the Systems.

Respectfully submitted,

  
Peggy G. Boykin, CPA  
Director

  
Tammy B. Davis, CPA  
Assistant Director, Payroll, Actuarial and Financial Reporting







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## Introductory Section

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### Governing Board and Administration

#### Governing Board - SC State Budget and Control Board

Mark Sanford, Chairman	Governor
Converse A. Chellis, III, CPA	State Treasurer
Richard Eckstrom	Comptroller General
Hugh K. Leatherman, Sr.	Chairman, Senate Finance Committee
Daniel T. Cooper	Chairman, House Ways and Means Committee
Frank W. Fusco	Executive Director

#### Retirement System Investment Commission<sup>1</sup>

Reynolds Williams	Chairman
Converse A. Chellis, III, CPA	State Treasurer
Blaine Ewing, III	
James R. Powers	
Allen R. Gillespie, CFA	
Robert L. Borden	Chief Investment Officer
Nancy E. Shealy	Administrative Director and General Counsel

#### Investment Consultant

New England Pension Consultants

#### Consulting Actuaries

Milliman Consultants and Actuaries  
Cavanaugh Macdonald Consulting, LLC

#### Retirement Systems Executive Management<sup>2</sup>

Peggy G. Boykin, CPA	Director
Jocelyn Caldwell	Project Management Officer & Interim Assistant Director – Customer Services
Sarah N. Corbett, CPA	Assistant Director – Administration
Tammy B. Davis, CPA	Assistant Director – Payroll, Financial and Actuarial Reporting
Amanda J. Green	Assistant Director – Customer Claims
Lisa Phipps	Assistant Director – Information Technology
Travis Turner, CPA	Assistant Director – Financial Employer Services
David Avant	General Counsel – Retirement Systems
John Page	Internal Auditor

#### Retirement Systems Staff Responsible for Compilation of CAFR

Tammy B. Davis, CPA	Payroll, Financial and Actuarial Reporting
Ashley Nichols, CPA	Payroll, Financial and Actuarial Reporting
Faith Wright	Payroll, Financial and Actuarial Reporting
Megan Reynolds	Public Information Officer
Angie Warren	Public Information Coordinator

<sup>1</sup>Refer to page 79 for a complete list of investment managers.

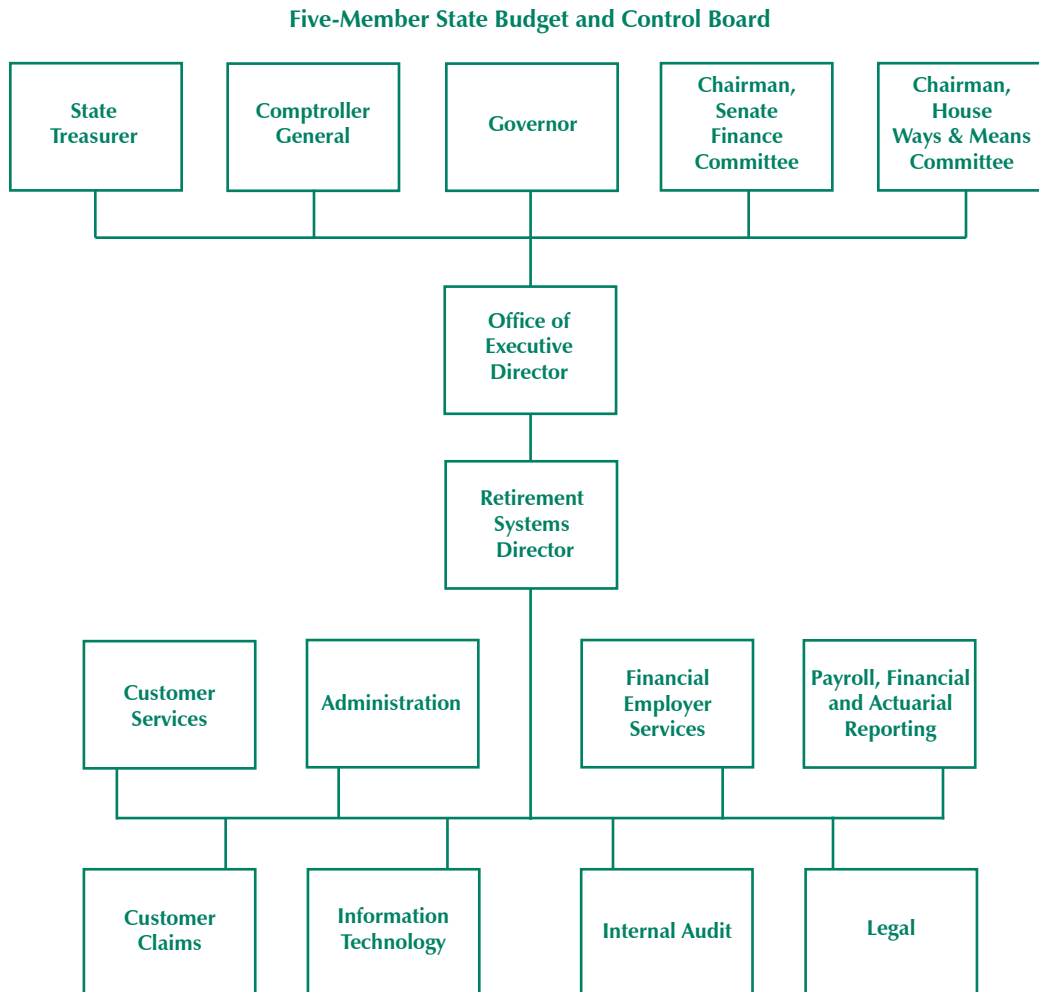
<sup>2</sup>As of August 31, 2007, due to the finalization of organizational changes initiated prior to June 30, 2007.



# Introductory Section

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## Organizational Chart



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## Introductory Section

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### Organizational Description

The structural organization of the Systems is depicted in the organizational chart on page 17. A brief description of the primary functions performed by each department follows:

#### Customer Services

Responsible for member consultations (in person, by telephone, on-line via the Internet, or by videoconferencing) in all phases of retirement operations; briefing governing bodies of prospective new employers on member benefits and new employer liability regarding potential costs associated with joining the Retirement Systems; training employers in all aspects of the Retirement Systems' member benefits, reporting procedures, and the Internet-accessed employer information system; meeting with employees as requested to present benefit overviews and pre-retirement education programs; and coordinating and conducting retirement seminars designed to better prepare members whose retirement is imminent.

#### Administration

Responsible for managerial, budgetary, and administrative oversight of all division operations; physical plant issues, operations, and maintenance; procurement; human resources activities; communications and public information; accounts payable; postal center operations; and courier services.

#### Payroll, Financial and Actuarial Reporting

Functioning as chief financial office for the Retirement Systems, responsibilities encompass maintaining comprehensive financial accounting systems, including actuary, investments and disbursements of benefit payments, for the five statutorially defined retirement plans. This department is responsible for preparation of the *Comprehensive Annual Financial Report* and *Popular Annual Financial Report* as well as staffing accounting roles for disbursing funds and reporting of financial data; tax reporting; managing daily financial operations; establishing financial policies and procedures; and communication related to actuarial valuations, legal issues and fiscal impact of proposed legislative changes. Benefit payments are disbursed in the form of monthly annuities, TERI distributions, refunds to terminated members, and death payments to beneficiaries.

#### Customer Claims

Responsible for the processing of customer claims relating to annuities, refunds, or death claims; the computation of the cost for purchases of prior service for all members of the Retirement Systems; and the auditing of service credit for our membership.

#### Information Technology

Responsible for the design, implementation and control of all automated applications within the Systems; and the maintenance of complete historical records of each member via digital imaging.

#### Financial Employer Services

Determining the average final compensation to be used in calculating a member's annuity benefit at retirement; collecting and allocating member and employer contributions; maintaining membership enrollment and beneficiary information; and the State Optional Retirement Program.

#### Legal

Responsible for representing the South Carolina Retirement Systems in matters before circuit and appellate courts and administrative bodies, and for providing program support to the management of the South Carolina Retirement Systems.

#### Internal Audit

Responsible for providing an independent appraisal function to examine and evaluate processes and policies, and for providing assurance to management regarding the internal control structure of the division.